

STRATEGIC POLICY RESEARCH

THE ABSENCE OF A PUBLIC POLICY RATIONALE FOR APPLYING AFFILIATE-TRANSACTION RULES TO AT&T

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**The Absence of a
Public Policy Rationale for
Applying Affiliate-Transaction
Rules to AT&T**

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I. Introduction

A. Qualifications

Strategic Policy Research Inc. (SPR) is an economics and telecommunications policy consulting firm located in Bethesda, Maryland. Dr. Haring and Dr. Rohlfs are principals of the firm. Dr. Haring formerly served as Chief Economist of the FCC and as Chief of the Commission's Office of Plans and Policy. He received his BA from the University of Virginia and PhD from Yale University in economics. Dr. Rohlfs was formerly Department Head for Economic Modeling Research at Bell Laboratories and has commented frequently in the Commission's common carrier dockets. He received his AB from Amherst College and PhD from the Massachusetts Institute of Technology in economics. Curriculum vitae for Dr. Haring and Dr. Rohlfs are attached to this submission.

B. Description of FCC Proceeding on Affiliate Transfers

On September 23, 1993, the FCC opened a proceeding to revise its rules governing transfers between regulated telecommunications carriers and their unregulated affiliates.¹ The proposed rules cover dominant interexchange carriers (IXCs) and local exchange carriers (LECs) other than average schedule companies.

¹Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251, adopted September 23, 1993 and released October 20, 1993.

In Paragraph 101 of the Notice of Proposed Rulemaking, the Commission requests comments regarding whether the rules should apply to AT&T. This submission responds to that request. Our analysis indicates that the public interest would be best served if the rules were no longer applied to AT&T.

C. Background on Affiliate Transfer Rules

The Commission promulgated the current affiliate-transfer rules under rate base, rate-of-return (ROR) regulation. The rules were intended to prevent regulated firms from achieving unwarranted rate increases for regulated services. The Commission's fear was that, under ROR regulation, a regulated carrier might pay excessive prices for goods and services that it purchases from unregulated affiliates. If the excessive payments were not detected, the carrier could apply for and justify a rate increase based on its artificially inflated cost of service. As a result, rates for regulated services would increase. Meanwhile, the unregulated affiliates would enjoy windfall profits. The Commission also feared that a regulated carrier might sell goods and services to unregulated affiliates at unreasonably low prices which did not cover costs. This practice, if undetected, would lead to the same result: unwarranted increases in regulated rates and windfall profits for unregulated affiliates.

In 1980, the Commission developed affiliate-transfer rules as part of its Computer II Inquiry.² Under those rules, regulated and unregulated operations had to be in "fully-separate" affiliates. The fully-separate affiliates generally could not share employees or assets or exchange software. All transactions had to be at arm's length. Carriers were required to reduce to writing and file with the Commission the complete terms of their transactions with their separate affiliates, and transactions were required to be compensatory (the carrier was to recover from its affiliate the full cost of transferred goods or services, including reasonable

²Amendment of §64.702 of the Commission's Rules & Regulations, Second Computer Inquiry, 77 F.C.C.2d 384; *modified on recon.*, 84 F.C.C.2d 50 (1980); *further modified on recon.*, 88 F.C.C.2d 512 (1981); *aff'd sub nom. Computer and Communications Industry Assn. v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983), *aff'd on second further recon* FCC 84-190 (released May 4, 1984).

profits, overhead and transaction costs, at the same terms, prices and conditions that would be available to a nonaffiliated purchaser).

The Commission revised these rules in its Computer III Inquiry. Under Computer III, regulated and unregulated operations need not be in fully-separate affiliates. Accounting for regulated versus unregulated operations is now specified in Parts 32 and 64 of the Commission rules. The rules specify the accounting treatment of transactions between regulated and unregulated affiliates.

The Commission now proposes to revise its affiliate-transaction rules in several respects. The present rules dictate specific methods that must be used in determining the amounts to record in Uniform System of Accounts (USOA) accounts for affiliate transactions, using particular valuation methods. The Commission cites as a problem the lack of arm's length transactions upon which to reliably measure how transactions should be valued. Its proposed rules would look beyond the prices affiliates pay each other and focus on the costs an affiliate group incurs in providing affiliate transactions. The proposed rules would limit use of prevailing company pricing in affiliate transactions to situations where a nonregulated affiliate sells at least 75 percent of its output to nonaffiliates. They also would require all affiliate transactions involving services, other than those provided pursuant to tariff or permitted at prevailing company prices, to be recorded at the higher of cost and estimated fair value when the carrier is the seller, and the lower of cost and estimated fair market value when the carrier is the purchaser.

D. Cost-Benefit Analysis

Cost-benefit analysis is the appropriate framework for analyzing the merits of proposed regulatory rules and the appropriate scope for their application. Regulatory rules generally have both beneficial and adverse consequences. They also cause the regulatory agency and the regulated company to incur direct costs for enforcement and compliance, respectively. Cost-benefit analysis inquires whether the beneficial consequences of the policy outweigh the adverse consequences plus the increase in direct costs.

Cost-benefit analysis can be used to determine whether proposed regulatory rules contribute or detract from the public interest. If the proposed rules make a positive net contribution (*i.e.*, where beneficial consequences less adverse consequences exceed direct costs), cost-benefit analysis can sometimes also be used to suggest how the rules should be configured to *maximize* the net contribution.

In the instant setting, careful evaluation of relevant costs and benefits leads to the conclusion that a policy of continuing to apply affiliate-transaction rules to AT&T would fail an elemental cost-benefit analysis. Such a policy cannot produce benefits given the existing competitive and regulatory environment. At the same time, it would impose significant costs and cause significant harm to the public interest. Given the absence of potential benefits, the presence of compliance and enforcement costs, and potential public interest harms, the application of these kinds of rules to AT&T cannot be justified.

II. Summary of Cost-Benefit Analysis

In this submission, we explain why the premise for applying the affiliate-transaction rules to AT&T has disappeared. Since the Commission first imposed the rules, there have been three important environmental changes:

- The long-distance market has become highly competitive. Prices are now primarily constrained by market forces. As a consequence, AT&T cannot profitably raise prices above competitive levels — no matter at what prices affiliate transactions take place.
- Much of AT&T's revenue is now derived from services subject to streamlined regulation. AT&T's pricing of its streamlined services is not subject to direct regulatory constraints. Affiliate transactions, no matter at what price, do not affect what AT&T is allowed to charge for services subject to streamlined regulation.
- Remaining interstate services are subject to price-cap regulation with no sharing of earnings. Prices for such services are limited by the price-cap formulae as well as basket and band constraints. Affiliate transactions, no matter at what price, do not affect what AT&T is allowed to charge for services subject to price-cap regulation.

For these reasons, AT&T cannot profit by setting inappropriate prices for affiliate transactions and, therefore, has no reason to do so. Furthermore, no matter how AT&T sets prices for affiliate transactions, customers are unlikely to be harmed. Consequently, we can see no beneficial consequences of applying affiliate-transactions rules to AT&T.

At the same time, the costs of enforcing and complying with the rules are substantial. Moreover, applying the rules to AT&T may jeopardize the efficient organization of supply and the full exploitation of the U.S. comparative advantage in network technologies.

Since the beneficial consequences are nonexistent while the costs and potential harms are significant, affiliate-transaction rules should *not* be applied to AT&T.

III. Competition

Competition in the long-distance marketplace effectively constrains AT&T's ability to benefit from inappropriate affiliate transactions. Today's long-distance market exhibits competitiveness, in terms of structure, conduct, and performance. "Structure" refers to the external environment that affects each firm in the market. "Conduct" refers to the rivalrous activities of firms in the market. "Performance" indicates how well the industry does in providing high-quality services at reasonable prices to customers.³

A. Structure

The structure of the long-distance market is conducive to, and indicative of, substantial competition. Competitors are present, customers are aware of these choices and freely exercise them, competitors can quickly expand production in response to market opportunities, and barriers to entry are low.

³In this paper, the discussion of competition is necessarily abbreviated. For a more comprehensive analysis that accords with our own views, see Michael E. Porter, "Competition in the Long Distance Telecommunications Market," Monitor Company, September 1993 and Robert E. Hall, *Long Distance: Public Benefits from Increased Competition*, Applied Economic Partners, October 1993.

1. Presence of Competitors

There are now reported over 500 long distance carriers providing service in the U.S., and at least 12 interexchange carriers serving every state.⁴ At least 12 carriers provide interexchange carrier service over their own fiber-optic facilities.⁵ Together AT&T's competitors account for 40 percent⁶ percent of total switched access minutes.

The presence of many competitors proves that the barriers to entry described below are, indeed, low. Literally hundreds of entrants have scaled those barriers and have survived in the market.⁷ Small competitors also limit the possibility of implicit (or explicit) oligopolistic cooperation by the larger long-distance carriers. The small carriers stand ready to expand their operations if the larger carriers charge excessive prices or offer inadequate quality of service.

2. Excess Transmission Capacity

The long-distance industry currently has substantial excess fiber-optic transmission capacity. Because of this excess fiber capacity, long-distance competitors can quickly expand production in response to market opportunities. The fiber capacity is already installed and the electronic equipment (switches and circuit equipment) needed to expand production can be installed relatively rapidly. This rapid response time limits the potential for even short-run oligopoly rents. The short-run incremental cost of expansion is low, since the capacity costs are already sunk.

⁴"Trends in Telephone Service," FCC, Industry Analysis Division, March 1993, p. 33, Table 20 and p. 34, Table 21.

⁵"Fiber Deployment Update - End of Year 1992," FCC, Industry Analysis Division, April 4, 1993, p.4.

⁶"Long Distance Market Shares, Second Quarter, 1993," FCC Industry Analysis Division, September 1993, Table 2.

⁷Carriers other than AT&T, MCI, and Sprint have grown from 3.3 percent of presubscribed lines at the end of 1987 to 6.1 percent at the end of 1992.

3. Barriers to Entry

Any long-distance carrier can get access from local exchange carriers on nondiscriminatory terms vis-à-vis any other long-distance competitor. As a result, each carrier has a ready-made, nearly universal⁸ distribution channel. A new entrant need not rely solely on its own facilities. There is an active market in which many firms sell fiber-optic capacity.⁹ Consequently, an entrant can operate on a relatively small scale without suffering a great penalty from lack of economies of scale.¹⁰ AT&T and other facilities-based carriers are also required to make their offerings available to similarly situated customers and may not deny an offering based on the fact that the customer also competes with the carrier. As a result, a competitive entrant can offer universal termination of calls, even if it operates only in a limited geographic region. Resale has been used by virtually all long-distance competitors and greatly facilitates competition. Stated in more general terms, a long-distance entrant need not produce a complete "product line." It can instead enjoy all the marketing advantages of a complete product line by reselling its competitor's products at a profit.

B. Conduct and Performance

In the previous subsection we described how the structure of the long-distance industry is conducive to vigorous competition. In this subsection, we discuss actual marketplace experience. We demonstrate that long-distance carriers behave and the long-distance market performs in an effectively competitive fashion.

⁸Local exchange carriers serve virtually all U.S. businesses and approximately 94 percent of U.S. residents. Alexander Belinfante, "Telephone Subscribership in the U.S.," FCC, Industry Analysis Division, Common Carrier Bureau, June 1992, Table 1.

⁹Jonathan M. Kraushaar, *Fiber Deployment Update—End of Year 1991*, FCC, Industry Analysis Division, Common Carrier Bureau, March 1992.

¹⁰In this regard we note that, in recent years, digital technology has greatly reduced the scale economies inherent in switching equipment.

During its initial price-cap period (1989-1992), AT&T often priced below its price caps. Such pricing was not necessary in order to meet any regulatory constraints. It was instead driven by competitive pressures.

Since divestiture, AT&T has offered a number of discounted rate plans, designed to make the company's services more competitive.¹¹ Other long-distance carriers have also effectively deployed discounted rate plans. In particular, MCI's "Friends and Family" plan has been extremely successful.¹² In addition, both AT&T and its competitors have negotiated a number of large contracts designed for particular customers.

Competitive marketing has key importance in the long-distance industry. AT&T spent 16.4 percent¹³ of its 1992 operating revenues on customer operations. MCI spent 26.5 percent of its annual net sales on selling and administrative expenses in 1992.¹⁴

In recent years, the long-distance industry has exhibited good economic performance — performance consistent with the operation of a competitive market. The industry has a good record of providing high-quality services at low prices. It compares favorably both to other industries in the United States and to telecommunications sectors in foreign countries.

During the price-cap period (1989-1992), AT&T's price reductions exceeded historical levels, and customers gained \$1.8 billion¹⁵ from the consumer dividend and AT&T's voluntarily pricing below the cap. These gains are in addition to the continuation of historical productivity growth of 2.5 percent per year. Prices of other long-distance carriers dropped by

¹¹Reach Out® America is targeted at residents. The PROSM family of services are targeted at small and medium-sized businesses. Megacom® and Software Defined Network Service are targeted at large customers. In addition, AT&T has negotiated Tariff 12 and Tariff 15 plans for its business customers (which are available to all similarly situated customers).

¹²"MCI Eager to Rumble with Industry Giants," Richmond Times-Dispatch, August 8, 1993, sBUS. Since Friends and Family was introduced in March of 1991, MCI's market share has grown by 2 percent, which translates into hundreds of millions of dollars of revenue.

¹³Annual Report of AT&T Communications to the FCC for the Year Ended December 31, 1992, pp. 21 and 21.2.

¹⁴1992 MCI Annual Income Statement.

¹⁵*Price Cap Performance Review for AT&T*, CC Docket No. 92-134, 8 FCC Rcd. 5165, released July 23, 1993.

similar amounts.¹⁶ AT&T's customers further reduced their cost of interstate service by 0.9 percent per year by taking greater advantage of discount plans. Altogether, customers reaped approximately 90 percent of the productivity gains associated with price-cap regulation.¹⁷

Competition greatly accelerated the process of converting the long-distance network from analog to digital. In the mid-1980s, Sprint converted to a 100 percent fiber-optic digital network. It aggressively touted the advantages of digital transmission in its famous pin-drop commercial. AT&T responded by rapidly phasing out its analog facilities in 1988 and 1989. AT&T took a \$6.7 billion write-off in 1988, as a result of this modernization.¹⁸

Finally, U.S. long-distance carriers have aggressively deployed innovative new services. In particular, the United States is the world leader in advanced 800 and virtual private network services.

C. Policy Implications

The fact that the long-distance market is competitive in terms of its structure, conduct, and performance implies that market forces substantially constrain AT&T's freedom to operate as it chooses. In particular, if AT&T's prices exceed the market level, AT&T will lose substantial business to competitors. Similarly, AT&T will suffer if competitors offer better quality or if it falls behind in offering innovative services that meet customers' needs.

It follows that competition severely limits AT&T's ability to achieve any benefit from affiliate transactions at inappropriate prices. Competition also limits the harm to customers if AT&T were nevertheless to pursue such transactions. For example, suppose that AT&T's regulated operations pay too much for inputs from unregulated affiliates. If AT&T had a monopoly subject to ROR regulation, it might (depending on regulatory competence and diligence) be able to pass the excess cost on to regulated customers. However, it does not.

¹⁶Porter, Exhibit 1.

¹⁷Richard Schmalensee and Jeffrey H. Rohlfs, *Productivity Gains Resulting from Interstate Price Caps for AT&T*, September 3, 1992, presented at the Telecommunications Policy Research Conference, October 4, 1993. The customer share is 95 percent if historical productivity growth is included in the gains.

¹⁸AT&T 1988 Annual Report, p. 27.

In the current interexchange market environment, competition itself limits prices in excess of market levels. The likely outcome of this affiliate transaction is that money would go from one of AT&T's pockets to another, and prices to consumers would not change. Such an internal accounting transfer has *no* public policy implications, since it does not affect consumers at all. If AT&T were unwisely to price above the market level, moreover, customers could easily protect themselves by switching to an alternative supplier.

Alternately, suppose that AT&T's regulated operations sell outputs to unregulated affiliates at prices that are excessively low. The revenue shortfall would, *ceteris paribus*, lower AT&T's rate of return. If AT&T were an ROR-regulated monopoly, it might (depending on regulatory competence and diligence) be able to raise regulated prices to make up for the shortfall. However, as before, this strategy simply will not work under competition. AT&T cannot raise rates without losing business to competitors, and customers can protect themselves from excessive rates by switching suppliers. Thus, there is no public policy basis for regulating AT&T's transactions with its affiliates.

IV. Streamlined Regulation

Many of AT&T's interstate services are subject to streamlined regulation. In particular, regulation is streamlined for virtually all of AT&T's former Basket 2 (inbound/800) services and Basket 3 (outbound business apart from analog private line) services. Services whose regulation is streamlined account for almost half of AT&T's interstate revenues.

Under streamlined regulation, AT&T must file tariffs. However, the filings require no cost support and are usually rapidly allowed to take effect. Furthermore, services subject to streamlined regulation are subject to *no* direct price regulation, including price caps. Thus, regulation does not constrain prices for services subject to streamlined regulation. AT&T can price as it chooses, limited only (but substantially) by market conditions. AT&T's profits from streamlined services are not limited by regulatory constraints, and AT&T is not guaranteed the opportunity to earn a fair return.

Unlike ROR regulation, streamlined regulation provides no incentive whatever to conduct affiliate transactions at inappropriate prices. AT&T can already price as it deems appropriate for such services. AT&T has no incentive to distort prices of affiliate transactions because such conduct would not provide AT&T with *any* pricing freedom or flexibility that it does not already have. Inappropriate prices for affiliate transactions would simply complicate AT&T's *internal* cost accounting and make internal cost control more difficult.

V. Price Caps

AT&T's interstate services that are not subject to streamlined regulation are subject to price cap regulation. Under price caps, the prices that AT&T can charge are limited by formulae that are set in advance. There are price cap constraints for each basket (Basket 1 and the few services remaining in Baskets 2 and 3). In addition, each service is subject to band constraints. The price-cap formulae were initially set on the basis of historical costs, and are adjusted on an on-going basis only for specific items — *i.e.*, inflation, access charges, and other exogenous factors. In other words, endogenous factors such as affiliate-transaction pricing have *no* effect on AT&T's remaining price caps. Furthermore, unlike the LEC price-cap plan, AT&T's price caps include no "sharing" mechanism. Consequently, the prices that AT&T is allowed to charge also do not depend at all on the profits that AT&T has earned in the past.

Price caps without a sharing obligation (in contrast to ROR) provide essentially no incentives for conducting affiliate transactions at inappropriate prices. The price-cap limits are independent of the prices of affiliate transactions. Consequently, distorting those prices has no benefit to AT&T. As before, it simply complicates AT&T's internal cost accounting and makes internal cost control more difficult. If AT&T were nevertheless to conduct affiliate transactions at inappropriate prices, customers would not be harmed since prices are

constrained by market forces and price-cap constraints, which are independent of affiliate transactions. AT&T would simply be transferring money from one of its pockets to another.¹⁹

VI. Costs of Regulation

The previous sections considered the virtually non-existent public benefits of regulating AT&T's affiliate transactions. This section discusses the substantial costs of such regulation. In addition to imposing direct costs of compliance and enforcement, regulation inevitably distorts the firm's incentives and leads to inefficient operations. The latter can be especially serious for AT&T, given the firm's vertically-integrated structure.

A. Direct Costs

Developing administrative systems for tracking affiliate transactions is expensive. Carrying out the administrative procedures on an ongoing basis is even more expensive. The Commission's affiliate transactions rules require detailed cost accounting on a fully-distributed cost (FDC) basis. This, in turn, requires FDC cost allocations for all inputs that are used to produce multiple outputs. These cost systems have little value to the firm, apart from regulatory compliance. In general, the use of FDC allocations is not appropriate for internal management purposes — unless the allocations happen to be reasonable proxies for marginal costs. Consequently, virtually the entire cost of constructing and maintaining the accounting system is a burden of regulation. Such compliance costs, and related costs such as those of an independent audit, are likely to be very substantial.

The proposed revision to the rules barring use of prevailing company pricing unless the unregulated affiliate sells at least 75 percent of its output to non-affiliates would be

¹⁹The only argument we can conceive for why AT&T might seek to conduct affiliate transactions at inappropriate prices is in hope of substantially reducing its rate of return and, on that basis, persuading the Commission to revise its remaining price caps upwards. In our view, that possibility is improbable. Based on its actions heretofore, the Commission will likely (and, in our view, certainly should) streamline regulation of all interstate services rather than formally renew price caps at some future time. Alternatively, in the event of a formal review, the Commission may simply extend the term of the plan, as it did earlier this year, instead of establishing a new plan. In either case, there is no incentive for AT&T to conduct affiliate transactions at inappropriate prices.

particularly burdensome and inappropriate for AT&T. Due to AT&T's vertically-integrated structure and its use of customized products and services, an AT&T affiliate would often be unable to meet the threshold of 75 percent third-party sales, even when it is a major supplier to an established third-party market for those goods and services. The 75 percent rule is also unnecessary under any economic theory. A market price is established if *any* significant group of market participants engages in arm's length transactions at that price. In particular, suppose that a significant group of customers buys a good or service at a certain price from an unregulated affiliate of AT&T. These transactions provide evidence that AT&T's regulated operations would have to pay *at least* that same price if they relied on external supply. Indeed, the next best source of supply, other than AT&T, may be at a higher price.

Regulatory monitoring of accounting reports is also a substantial burden on the Commission. The Commission must ensure that the accounting manual embodies the Commission's intent and that accounting practices accurately implement the manual. Such monitoring is a time-consuming task, which deflects the Commission's valuable human resources from the Commission's other important responsibilities. For example, this type of activity deflects resources from regulation of cable rates and charges for various access services. Given the binding resource constraints under which the Commission operates, it should allocate its scarce resources to that set of regulatory activities which will maximize public benefits. It is highly unlikely that applying affiliate-transaction rules to AT&T maximizes public-benefits or optimizes allocation of the Commission's scarce enforcement resources.

B. Incentives to Operate Inefficiently

The Commission's rules on affiliate transactions provide a strong incentive for companies to use external, rather than internal, sources of supply. By using external sources, the company avoids the burden of developing and implementing new regulatory accounting systems. It also avoids the risk that regulators will find fault with the company's accounting methods, even if carried out in good faith.

These artificial regulatory incentives are counterproductive if self-supply is more cost-effective than outside supply. The company may respond to the artificial incentives by relying excessively on outside supply. The consequences would be higher costs, lower productivity and a loss of competitiveness.

An important advantage of self-supply is that the company can better customize inputs to meet specialized needs. For example, customized equipment may be required to meet the security needs of military customers. AT&T, with Bell Laboratories, has excelled in meeting such specialized needs. No constructive public purpose is served by erecting regulatory barriers that prevent effective coordination of R&D, manufacturing and provision of services. The value that the United States derives from Bell Laboratories, which is a unique national resource, would thereby be diminished to the detriment not just of AT&T, but also of U.S. productive enterprise more generally.

Most sophisticated telecommunications equipment not produced by AT&T is produced by foreign suppliers. Hence, if AT&T relies on outside supply, foreign suppliers are the likely beneficiaries. Thus, the Commission's affiliate-transfer rules could have the anomalous effect of inducing AT&T to substitute foreign supply for domestic supply.

VII. Conclusion

It has been suggested that the first principle of good policymaking, like good medical care, is "to do no harm." Simple cost-benefit analysis indicates that continued application of affiliate-transaction rules to AT&T would violate this fundamental principle. AT&T plainly operates in a highly competitive environment. Any attempt by AT&T to raise prices would simply afford its rivals an opportunity for expansion — an opportunity they have repeatedly proven themselves capable of exploiting in short order. Given this first line of defense, there is little good that application of affiliate-transaction rules to AT&T can accomplish. Residual regulation of AT&T is a combination of streamlined regulation and pure price caps with no provision for sharing earnings. Such regulation provides an important second line of defense; namely, affiliate transactions at inappropriate prices cannot increase the prices that AT&T is

allowed to charge. Hence, application of the rules to AT&T is unlikely to provide any public benefits.

At the same time, application of the rules to AT&T clearly does carry significant costs. In particular, the value of alternative deployments of scarce regulatory resources is necessarily foregone. In addition, given AT&T's vertically-integrated structure, application of affiliate transaction rules to AT&T has a significant potential for causing harm to the public interest. The rules could bias AT&T's input acquisition process against efficient self-supply and limit its ability to translate new ideas and technologies into new, empowering products and services. If this occurred, the pace of productivity advance and product and service innovation would be counterproductively restrained. Given the integral role telecommunications plays in today's economy, any adverse consequences for the competitiveness of American enterprises certainly need to be seriously weighed by the Commission in its deliberations. In our view, the idea that AT&T should be constrained in how it exploits its technology and intellectual capital for its own advantage and the advantage of its customers, *given the operation of both credible competitive market and regulatory constraints against any abuse of power*, is hard to seriously credit.

We believe that, in raising this issue, the Commission has positioned itself to take advantage of an excellent opportunity to further rationalize its regulation of the long-distance marketplace in the public interest. By relieving AT&T of the need to comply with these rules, the Commission can conform its regulation better to today's marketplace (not to mention regulatory)²⁰ realities and free-up valuable resources to address real problems of pressing concern.

²⁰ Affiliate-transaction rules were originally conceived to address a potential disability of rate-base, ROR regulation, a disability that is not suffered by the streamlined and price-cap regulation currently governing AT&T's pricing.

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He served as Chief Economist at the Federal Communications Commission and Chief of the Commission's Office of Plans and Policy. At the FCC, he was a leading exponent of incentive regulation and pricing freedom for telephone companies operating in competitive environments. He was a chief architect of the Commission's price-cap regulatory reform plans as well as its efforts to strengthen resource rights in the electromagnetic spectrum and in broadcast programming.

Prior to his six years at the FCC, he was Visiting Professor of Economics at the University of Virginia, worked as a private economic consultant and served consecutively on the staffs of the Federal Trade Commission's Bureau of Economics, the Civil Aeronautics Board's Office of Economic Analysis and the U.S. Department of Justice's Economic Policy Office. He has prepared papers and reports on a wide range of subjects including telecommunications economics and regulation as well as accounting standards, conglomerate mergers, energy policy and resources and the OPEC cartel.

His articles have been published in the *Journal of Business*, *Land Economics*, *The American Economic Review*, *The Wall Street Journal*, the *IEEE Proceedings*, the *Federal Communications Bar Journal* and the *Annals of the Institute of Public Utilities*. He is the author of five papers in the FCC's Office of Plans and Policy Working Paper Series and the "Telecommunications" entry in the *Fortune Encyclopedia of Economics*.

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